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No. 280

In the Supreme Court of the United States

OCTOBER TERM, 1941

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SOUTHWEST CONSOLIDATED CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statute involved	2
Statement	3
Specification of errors to be urged	5
Reasons for granting the writ	5
Conclusion	9
Appendix	10

CITATIONS

Cases:

Commissioner v. *Alabama Asphaltic Limestone Co.*, decided May 5, 1941 — 6, 7, 8

Commissioner v. *Bondholders Committee, Marlborough Investment Co.*, 118 F. (2d) 511 — 6, 7, 8

Commissioner v. *Meyer Buchman*, pending on petition for review — 6

Commissioner v. *Cement Investors, Inc.*, pending on petition for review — 6

Commissioner v. *New Haven & Shore Line Ry. Co.*, pending on petition for review — 6

Commissioner v. *New President Corp.*, pending on petition for review — 6

Commissioner v. *James Q. Newton Trust*, pending on petition for review — 6

Commissioner v. *Palm Springs Holding Corp.*, decided May 14, 1941 — 6, 7, 8

Helvering v. *Elkhorn Coal Co.*, 95 F. (2d) 732, certiorari denied, 305 U. S. 605 — 7

Helvering v. *Tyng*, 308 U. S. 527 — 5, 6, 7

LeTulle v. *Scofield*, 308 U. S. 415 — 5, 6, 7

United States v. *Galveston-Houston Electric Co.*, 84 F. (2d) 516, certiorari denied, 299 U. S. 590 — 9

Statute:

Revenue Act of 1934, c. 277, 48 Stat. 680:

Sec. 112 (U. S. C., Title 26, Sec. 112) — 10

Sec. 113 (U. S. C., Title 26, Sec. 113) — 11

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The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Fifth Circuit entered in the above case on April 19, 1941, affirming a decision of the United States Board of Tax Appeals.

OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals (R. 31–45) is unpublished. The opinion of the Circuit Court of Appeals (R. 63–67) is reported in 119 F. (2d) 561.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 19, 1941 (R. 67). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Pursuant to plan, corporate assets were bought in by a bondholders' committee at equity foreclosure and receivership sales. The property was transferred to the taxpayer, a new corporation, in exchange for stock which was distributed to participating creditors, and for stock purchase warrants which were distributed in part to creditors and in part to former stockholders. The question is whether the basis for computing gain or loss upon the subsequent disposition, etc., of the assets by the new corporation is the same as it would be in the hands of the old corporation under Section 113 (a) (7) of the Revenue Act of 1934. The answer depends upon whether the acquisition of the assets by the new corporation constituted a "reorganization" within Section 112 (g) (1).

STATUTE INVOLVED

The statute involved will be found in the Appendix, *infra*, pp. 10–12.

STATEMENT

Southwest Gas Utilities Corporation, the taxpayer's predecessor corporation (hereafter referred to as Utilities) had outstanding in 1932, $2,871,500 face amount of 6½% First Lien and Secured Sinking Fund Gold Bonds, together with unsecured claims, preferred stock, and common stock. Upon default in the interest payment on the bonds due May 1, 1932, a bondholders' committee was formed, which obtained the deposit of approximately 85% of the bonds. Members of the committee later became directors of Utilities and after October 7, 1932, were in control of the company (R. 31–32).

The following year, receivers were appointed by the Delaware Chancery Court in a consent proceeding (R. 32). In March 1934 a plan was proposed. The plan provided for the formation of a new company, which would acquire the assets of Utilities in exchange for its common stock and its Class A and Class B stock purchase warrants.[1] The common stock would be issued pro rata to the old bondholders, except for a small portion which, together with the Class A warrants, would be issued to unsecured creditors. The Class B warrants would be issued to the preferred and common stockholders (R. 33–34).

[1] The Class B warrants provided a higher purchase price, but both classes expired in 1938 (R. 33).

On May 11, 1934, the Chancellor issued a decree approving the plan. Thereupon, pursuant to the plan and to court order, the assets pledged as security for the bonds were sold at foreclosure sale on June 25, 1934, and were bid in by the bondholders' committee for $660,000. The unpledged assets were sold at public auction on June 18, 1934, and were bought by the committee for $92,000 (R. 34). The fair market value of the assets at this time was $1,766,694.98 (R. 38).

The taxpayer was formed on June 27, 1934; thereafter the committee transferred Utilities' assets to it; and the stock and warrants were distributed pursuant to the plan (R. 31, 38). Non-participating creditors received a pro rata distribution in cash (R. 37).

The cost basis in the hands of Utilities of the assets acquired by the taxpayer had been $8,995,724.91 (R. 38). The taxpayer used this basis in computing gains and losses on the acquired assets in its income and excess-profits tax returns for the period June 27, 1934, to December 31, 1934, and for the calendar year 1935. The Commissioner, in determining deficiencies, used as the basis the cost of the assets to the committee, namely, the aggregate of $752,000 paid for them at the foreclosure and receivership sales (R. 38–40).

The Board of Tax Appeals, rejecting the Commissioner's position, decided that there was no deficiency for either year (R. 46). The court below affirmed.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In holding that the taxpayer's assets had been acquired in connection with a "reorganization" of Utilities and that therefore their basis was the cost to that company.

(2) In failing to hold that the basis of the assets was their cost to the bondholders' committee at the foreclosure and receivership sales.

(3) In sustaining the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

This case presents a question of general importance in the administration of the revenue laws as well as a conflict among the circuits.

1. This is one of a number of test cases that the Government has pressed following this Court's decisions in *LeTulle* v. *Scofield*, 308 U. S. 415, and *Helvering* v. *Tyng*, 308 U. S. 527. Those decisions held that a transfer of assets or stock of one corporation to another in exchange for bonds or other obligations of the transferee did not constitute a "reorganization" within the meaning of the revenue acts. The Court ruled that the transfer could qualify as a reorganization only if there was a continuity of proprietary interest in the two corporations, and that the mere fact that the old stockholders became creditors of the new corpora-

tion was not sufficient. The instant case presents the precise converse of the *LeTulle* and *Tyng* cases. Here, the stockholders of the new corporation were the bondholders of the old.

The Government has taken the position that the difference is immaterial and has so contended in a series of test cases after the *LeTulle* and *Tyng* decisions.[2] In view of the large number of readjustments of corporate structures in the last decade where the creditors of a corporation became the stockholders of a new corporation which succeeded to the business of the old, the issue is obviously one of general fiscal importance.[3]

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[2] The fact that stock warrants in the new corporation had been issued to the stockholders in the old is immaterial here, for, as the court below properly recognized (R. 65), the warrants did not create any interest in the new corporation. This follows *a fortiori* from the *Tyng* case where convertible obligations were held not to create a proprietary interest.

[3] In addition to the instant case, the issue is raised in *Commissioner* v. *Bondholders Committee, Marlborough Investment Co.*, 118 F. (2d) 511 (C. C. A. 9th), pending on petition for certiorari, Nos. 128, 129, 1941 Term; *Commissioner* v. *Palm Springs Holding Corp.* (C. C. A. 9th), decided May 14, 1941, not yet officially reported but found in 1941 C. C. H., Vol. 4, par. 9470; *Commissioner* v. *Alabama Asphaltic Limestone Co.* (C. C. A 5th), decided May 5, 1941, not yet officially reported but found in 1941 C. C. H., Vol. 4, par. 9452; *Commissioner* v. *Meyer Buchman*, pending on appeal to C. C. A. 2d; *Commissioner* v. *New Haven & Shore Line Ry. Co.*, pending on appeal to C. C. A. 2d; *Commissioner* v. *New President Corp.*, pending on appeal to C. C. A. 8th; *Commissioner* v. *James Q. Newton Trust*, pending on appeal to C. C. A. 10th; *Commissioner* v. *Cement Investors, Inc.*, pending on appeal to C. C. A. 10th.

2. In holding the *LeTulle* and *Tyng* cases inapplicable, the decision below is in conflict with the decisions in two of the test cases recently decided by the Circuit Court of Appeals for the Ninth Circuit. *Commissioner* v. *Bondholders Committee, Marlborough Investment Co.*, 118 F. (2d) 511; *Commissioner* v. *Palm Springs Holding Corp.*, decided May 14, 1941.[4] The taxpayer has petitioned for certiorari in the *Marlborough* case, Nos. 128, 129, 1941 Term, and the Government has filed a memorandum not opposing.

The court below professed to distinguish the *Marlborough* decision on the ground that it involved no initial plan of reorganization but a series of happenings from which the Board of Tax Appeals inferred the existence of a plan. The distinction is without substance, however, since the Circuit Court of Appeals for the Ninth Circuit, in deciding the *Marlborough* case, accepted the Board's finding that there was a plan; and in any event, a unifying contract is not required. Cf. *Helvering* v. *Elkhorn Coal Co.*, 95 F. (2d) 732, 738 (C. C. A. 4th), certiorari denied, 305 U. S. 605. Moreover, even if the distinction were valid, it would not resolve the conflict between the two circuits, in view of the decision in the *Palm Springs*

[4] In accord with the decision below among the recent group of cases, however, is *Commissioner* v. *Alabama Asphaltic Limestone Co.*, decided by the court below on May 5, 1941, in which the Government intends to petition for certiorari.

case, where the record shows the existence of a formal plan.

Conversely, the Circuit Court of Appeals for the Ninth Circuit in the *Palm Springs* case professed to distinguish the instant case on the ground that "stock of the transferee was exchanged for stock, as well as bonds, of the transferor, thus permitting the transferor's stockholders to retain a proprietary interest in the corporate enterprise." This is a misconception, probably stemming from the fact, noted by the court below, that some of the bondholders agreeing to the plan also held stock in the old company. Stockholders of the old corporation, *qua* stockholders, received only stock purchase warrants.[5] None of the creditors participated in the new company by reason of their stock holdings. Although the court below intimated that some weight should be attached to this duality of holding, the circumstance is properly of no significance.

3. The decision of the court below is also inconsistent with the plain language of the statute. The court apparently regarded the transaction as a "reorganization" within the definition either of Clause B or Clause C of Section 112 (g) (1) of the Revenue Act of 1934, without making it clear

[5] Neither warrants nor any other securities were issued to former stockholders in the *Marlborough*, *Palm Springs*, or *Alabama Asphaltic* cases.

whether its reliance was on one or both. Even under the reasoning of the court below, Clause B is inapplicable because, in view of the warrants, the exchange was not made "solely" for voting stock. Clause B is also inapplicable because the assets acquired were not, at the time of acquisition, the assets of another corporation. Clause C is inapplicable first, because the transfers were not made by the old corporation, but by the indenture trustee and the receivers (cf. *United States* v. *Galveston-Houston Electric Co.*, 84 F. (2d) 516 (C. C. A. 1st), certiorari denied, 299 U. S. 590), and secondly, because neither the old corporation nor its stockholders were thereafter in "control" of the transferee.*

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition should be granted.

CHARLES FAHY,
Acting Solicitor General.

JULY 1941.

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* The court below did not discuss in its opinion the alternate argument that this transaction was a reorganization within the definition of Clause D or E, presumably recognizing that these clauses were patently inapplicable. Similarly, the court did not discuss the alternate argument that Section 113 (a) (8) and (b) (5) of the Act applied. While these sections permitted the taxpayer the basis of the assets in the hands of the committee, they are inapplicable on their face with respect to the initial transfer from the corporation.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

* * * * *

(5) *Transfer to Corporation Controlled by Transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * *

(g) *Definition of Reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected.

* * * * *

(h) *Definition of Control.*—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

* * * * *

(U. S. C., Title 26, Sec. 112.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(7) *Transfers to Corporation where Control of Property Remains in Same Persons.*—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock

or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

(8) *Property acquired by Issuance of Stock or as Paid-in Surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

(U. S. C., Title 26, Sec. 113.)